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INFO OCT-01 ISO-00 EURE-00 AID-20 CIAE-00 COME-00 EB-11

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E.O. 11652: N/A

TAGS: EFIN, IT

SUBJECT: VIEWS OF MILANESE BANKERS ON ITALIAN FINANCIAL SITUATION

1. SUMMARY. DURING VISIT TO MILAN BY TREAS ATT
JUNE 18-20 FOLLOWING WERE MAIN POINTS MADE BY
MILANESE BANKERS: (1) DOMESTIC CREDIT IS GROWING
INCREASINGLY TIGHT, PARTICULARLY FOR FOREIGN BANKS IN
ITALY, BUT IT HAS NOT YET HAD MUCH EFFECT ON PRODUCTIVE
ACTIVITY: (2) RESULT TO DATE OF PRIOR IMPORT DEPOSIT
SCHEME IS TO REDUCE DOMESTIC LIQUIDITY RATHER THAN TO
REDUCE IMPORT PAYMENTS, ALTHOUGH IT MAY BE AFFECTING
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IMPORT VOLUME;(3) TIGHT CREDIT HAS ALREADY (OR MAY SHORTLY)

INDUCE SOME REFLOW OF ITALIAN CAPITAL BACK TO ITALY;
(4) ITALIAN EXPORT PRICES ARE STILL FAIRLY COMPETITIVE
EVEN WITHOUT FURTHER DEPRECIATION AND THERE IS SOME MARGIN
OF PRODUCTIVE CAPACITY AVAILABLE FOR EXPORTS EVEN WITHOUT
REDUCING DOMESTIC CONSUMER DEMAND; (5) LIRA EXCHANGE RATE
SHOULD BE ALLOWED TO DEPRECIATE BY FURTHER 15 PERCENT OR
SO; (6) FOREIGN CREDIT IS NOW LARGELY LIMITED TO SHORT-
TERM BANK CREDITS AND MOST FOREIGN BANKS ARE AWAITING
EVIDENCE OF ADEQUATE STABILIZATION PROGRAM BEFORE RE-
OPENING LONGER TERM CREDIT; AND (7) RECENT G-10 DECISION TO
PERMIT CENTRAL BANKS TO USE GOLD AS COLLATERAL FOR FOREIGN
LOANS IS OF PSYCHOLOGICAL VALUE BUT DOES NOT ABSOLVE ITALY
OF NEED TO DEAL WITH BASIC PROBLEMS. END SUMMARY.

2. GROWTH PROSPECTS. COMPARED TO GENERAL SENSE OF FINANCIAL
AND POLITICAL CRISIS IN ROME, MILANESE BANKERS AND (AC-
CORDING TO THEM) INDUSTRIALISTS DO NOT YET SEEM TO FEEL
EFFECTS OF PRESENT "CRISIS." EVIDENCE SUGGESTS THAT
INDUSTRIAL PRODUCTION, EXCEPT FOR FEW SEAK SPOTS LIKE
PRIVATE AUTOS, IS STILL GROWING IN VERY SATISFACTORY WAY.
(APRIL INDUSTRIAL PRODUCTION INDEX WAS 14.2 PERCENT OVER
APRIL 1973 AND FIRST FOUR MONTHS INDEX WAS UP 14.9 PERCENT
OVER SAME PERIOD OF 1973. THESE FIGURES SHOULD BE DIS-
COUNTED BY FACT OF METALMECHANICAL STRIKE IN EARLY 1973.
HOWEVER, EVEN TAKING THIS INTO ACCOUNT, PICTURE LOOKS
QUITE GOOD.) SINCE FIRST HALF OF YEAR IS NEARLY OVER AND
SUMMER MONTHS ARE ALWAYS SEASONALLY SLOW, IT APPEARS THAT
MOMENTUM OF 1973 ECONOMIC RECOVERY AND EARLY 1974 GROWTH
MAY CONTINUE LONG ENOUGH INTO 1974 TO RESULT IN
GOOD GNP GROWTH THIS YEAR, DESPITE ANY DOWNTURN IN LAST
QUARTER. ALTHOUGH CREDIT IS TIGHT, THERE IS UNIVERSAL
AGREEMENT THAT BUSINESS HAS BUILT UP VERY LARGE STOCKS OF
IMPORTED MATERIALS WHICH SHOULD PROVIDE SOME CUSHION AS
CREDIT AND OTHER STABILIZATION MEASURES BEGIN TO BITE.

3. CREDIT CONDITIONS. ALL BANKERS THOUGHT THAT CREDIT WAS
"TIGHT" AND CITED RAPID RISE IN INTEREST RATES. FOR
EXAMPLE, PRIME RATE IS NOW IN RANGE 16-18 PERCENT AND
SOM BORROWERS ARE PAYING 20 PERCENT OR MORE. PRIME RATE
AT END APRIL WAS ABOUT 11 PERCENT. SENSITIVE 48 HOUR INTER-
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BANK RATE ON JUNE 20 WAS 17.75 PERCENT COMPARED TO 13.00
PERCENT ON APRIL 27. THREE-MONTH RATE WAS 18.75 PERCENT
COMPARED TO 14.00 PERCENT ON APRIL 27. BECAUSE AMERICAN
BANKS IN ITALY ARE TYPICALLY MORE DEPENDENT ON INTER-
BANK FUNDS TO FINANCE THEIR LENDING, THEY TENDED TO
VIEW CREDIT SITUATION AS TIGHTER THAN DID ITALIAN BANKS
WHICH HAVE BROADER AND LOWER COST DEPOSIT BASE. HOWEVER,
AMERICA BANKERS SAID THAT SOME LARGE ITALIAN BANKS

HAVE RECENTLY FAILED TO MEET CLEARING HOUSE SETTLEMENT COMMITMENTS ON TIME. ONE AMERICAN BANKER SUGGESTED THAT CREDIT TIGHTNESS WAS PARTLY "ARTIFICIAL" REFLECTING PERSUASION BY BOI GOVERNOR CARLI WORKING THROUGH BIG STATE-OWNED BANKS; HOWEVER, THIS WAS NOT COMMON VIEW. BANKERS WERE PARTICULARLY CONCERNED ABOUT 15 PERCENT ANNUAL CREDIT CEILING FOR WHICH INITIAL DEADLINE IS END-SEPTEMBER WHEN CREDIT INCREASE MUST BE NO MORE THAN 8 PERCENT ABOVE END-MARCH 1974 LEVEL. SINCE MANY BANKS APPARENTLY DID NOT MEET OLD 12 PERCENT LIMIT EFFECTIVE LAST MARCH AND NEW LIMIT IS BASED ON CEILING FIGURE RATHER THAN ACTUAL CREDIT POSITION, THEY HAVE EVEN LESS LEEWAY FOR MEETING SEPTEMBER DEADLINE. WHILE CREDIT LIMITS MAY BE EXCEEDED BETWEEN NOW AND DEADLINE, IT IS DIFFICULT TO FIND BORROWERS WHICH ARE ABLE TO REPAY IN THAT SHORT A PERIOD. ALSO, SUCH SHORT-TERM CREDITS MAKES FINANCIAL PLANNING BY BUSINESS MORE DIFFICULT. SEVERAL BANKERS STRESSED POINT THAT ITALIAN INDUSTRY IS HIGHLY DEPENDENT ON BANK CREDIT. THUS, RESULT OF CREDIT SQUEEZE IS NOT JUST TO CAUSE POSTPONEMENT OF NEW LONG-TERM INVESTMENT BUT ALSO TO AFFECT FINANCING NEEDED FOR CURRENT PRODUCTION. WHILE ITALIAN BUSINESSMEN HAD EARLIER SOUGHT TO MAXIMIZE AVAILABLE CREDIT LINES, THEY ARE NOW DRAWING ON THESE LINES AND BANKERS DID NOT THINK THAT THERE WAS MUCH BUSINESS LIQUIDITY TO SERVE AS CUSHION AGAINST CREDIT SQUEEZE.

4. PRIOR IMPORT DEPOSIT. THERE WAS GENERAL AGREEMENT THAT AT LEAST INITIAL IMPACT OF PRIOR IMPORT DEPOSIT MEASURE HAS BEEN TO ABSORB DOMESTIC LIQUIDITY AND TO ENCOURAGE FOREIGN FINANCING. LATTER TAKES FORM OF LONGER PAYMENT TERMS FROM FOREIGN SUPPLIERS WHO ARE TRYING TO PROTECT THEIR MARKETS, PERHAPS SOME FOREIGN OFFICIAL EXPORT LIMITED OFFICIAL USE

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CREDIT, AND INCREASES IN INTRA-COMPANY CREDIT. STILL, SOME BANKERS THOUGHT THAT VOLUME OF IMPORTS MAY HAVE BEEN AFFECTED, ALTHOUGH THIS MAY NOT SHOW UP IN STATISTICS BASED ON VALUE BECAUSE OF PRICE RISES. ALSO, IT WAS NOT YET CLEAR WHETHER DEMANDS FOR FINANCING OF DEPOSIT WERE RELATED TO OLD ORDERS OR ORDERS PLACED AFTER DEPOSIT MEASURE WAS INTRODUCED. STILL, GENERAL VIEW WAS THAT, AS LONG AS INDUSTRIAL ACTIVITY CONTINUES AT PRESENT SATISFACTORY PACE, THERE WILL BE EFFORT TO MAINTAIN IMPORT LEVELS.

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5. REPATRIATION ITALIAN CAPITAL ABROAD. SOMEWHAT SURPRISINGLY THERE WERE SEVERAL BANKERS WHO THOUGHT THAT SOME ITALIAN CAPITAL HAD ALREADY BEEN REPATRIATED TO ITALY AND MORE COULD BE EXPECTED AS RESULT OF TIGHT CREDIT IN PRESENCE OF GOOD INDUSTRIAL GROWTH PROSPECTS. ONE BANKER CITED RELATIVE STABILITY RECENTLY IN LIRA-SWISS FRANC BLACK MARKET RATE AS EVIDENCE OF RETURN FLOW.

6. EXPORT PRICES AND EXPORT CAPACITY. THERE WAS RATHER GENERAL AGREEMENT THAT EXISTING ITALIAN EXPORT PRICES ARE COMPETITIVE IN INTERNATIONAL MARKETS, EVEN WITHOUT ANY FURTHER DEPRECIATION OF LIRA. ON OTHER HAND, THERE WAS LIMITED OFFICIAL USE

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SOME CONCERN THAT WAGE AND LABOR PRODUCTIVITY DIFFICULTIES COULD SPELL TROUBLE IN LONGER RUN. THERE WAS ALSO GENERAL VIEW THAT THERE WAS SUFFICIENT EXISTING EXPORT CAPACITY TO PERMIT ITALY TO MEET GROWTH IN FOREIGN DEMAND, EVEN APART FROM ANY REDUCTION IN CONSUMER DEMAND WHICH MAY OCCUR DUE TO STABILIZATION MEASURES. HOWEVER, SOME CONCERN WAS EXPRESSED ABOUT GROWTH PROSPECTS IN ITALY'S MAIN EXPORT MARKETS.

7. LIRA EXCHANGE RATE. THERE WAS GENERAL BELIEF THAT PRESENT EXCHANGE RATE STRUCTURE E.G., (ABOUT 650 LIRE PER DOLLAR) WAS NOT ADEQUATE TO RESTORE EQUILIBRIUM IN ITALY'S BALANCE OF PAYMENTS, PARTICULARLY TAKING PSYCHOLOGICAL FACTORS INTO ACCOUNT. LOWEST FIGURE (WITH DOLLAR REPRESENTING WEIGHTED AVERAGE RATE) MENTIONED WAS 700 LIRE PER DOLLAR. ON OTHER HAND, TALK OF 750-800 LIRA/DOLLAR RATE SEEMED TOO HIGH. AVERAGE VIEW CENTERED AROUND RATE OF ABOUT 750 LIRE, REPRESENTING ABOUT 15 PERCENT ADDITIONAL DEPRECIATION FROM CURRENT WEIGHTED AVERAGE DEPRECIATION OF ABOUT 19 PERCENT SINCE SECOND DOLLAR DEVALUATION IN FEBRUARY 1973. WHILE ADMITTING THAT EXPORT PRICES SEEMED FAIRLY COMPETITIVE ALREADY AND THAT MOST IMPORTS WERE NOT VERY PRICE ELASTIC, THERE SEEMED TO BE FEELING THAT DOWNWARD RATE MOVEMENT WOULD, ON BALANCE, HAVE FAVORABLE EFFECT ON BOTH.

8. FOREIGN CREDIT PROSPECTS AND GOLD. THERE WAS GENERAL FEELING AMONG AMERICAN BANKERS THAT THEIR HEAD OFFICES HAD ABOUT REACHED CEILING OF CREDIT LIMIT FOR ITALY AND THAT NEW TERM LOANS WOULD DEPEND AT LEAST ON ADEQUATE STABILIZATION PROGRAM OR ON PROGRAM PLUS EVIDENCE THAT IT WAS HAVING DESIRED EFFECT. HOWEVER, ONE OF LARGEST BANKS SAID THAT IT WAS STUDYING POSSIBILITY OF HEADING UNDERWRITING GROUP FOR TWO NEW EUROMARKET TERM LOANS TOTALLING \$300 MILLION. BANK WAS PREPARED TO UNDERWRITE ABOUT 20 PERCENT OF LOAN, BUT WOULD NOT GO AHEAD IF IT COULD NOT FIND SUFFICIENT INTEREST AMONG OTHER BANKS. ANOTHER BANK NEW TO ITALIAN SCENE WHICH HAS NO HISTORIC "CEILING" AND WISHES TO ESTABLISH ITSELF BETTER IN ITALY WAS STILL OPEN TO CREDIT REQUESTS BUT IT WISHED TO HAVE SHARE OF LIRA COUNTERPART IN FACE OF ITS SMALL LIRA DEPOSIT LIMITED OFFICIAL USE

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BASE AND UNAVAILABILITY OF INTERBANK FUNDS. ONE ITALIAN BANK CLAIMED THAT BANK OF ITALY WAS ENCOURAGING US BANKS IN ITALY TO BORROW ABROAD PROVIDED THAT LOANS WERE AT MEDIUM-TERM. TWO OF BIGGEST ITALIAN COMMERCIAL BANKS CLAIMED THAT SHORT-TERM FOREIGN CREDIT WAS STILL AVAILABLE. EVALUATION OF RECENT G-10 DECISION GIVING BLESSING TO USE OF CENTRAL BANK GOLD FOR FOREIGN GOLD COLLATERAL LOANS

WAS VIEWED WITH CAUTION. ONE AMERICAN BANKER WARNED THAT, IF ONE COMMERCIAL BANK RECEIVED COLLATERAL, ALL WOULD WANT IT AND PREVIOUS CREDITORS MIGHT BE UNHAPPY. ANOTHER US BAKER THOUGHT THAT GOLD LOANS WOULD HAVE TO BE BASED ON PRICE LOWER THAN MARKET PRICE. ALSO, IT WOULD BE BEST TO AVOID PUBLICITY ABOUT TERMS OF LOAN. TO EXTENT GOLD WAS USED TO SECURE LOAN FROM FOREIGN CENTRAL BANKS, PROBLEM MIGHT BE REDUCED. ONE BANKER THOUGHT THAT ITALY WAS NEGOTIATING GOLD COLLATERAL LOAN FROM BUNDESBANK. ANOTHER THOUGHT SOME GOLD COLLATERAL CREDIT FROM BIS MIGHT BE IN THE WORKS. PRESIDENT OF ITALY'S SECOND LARGEST BANK WITH CLOSE TIES TO BOI AND GOVERNMENT ASSURED TREASATT THAT CARLI AND COLOMBO HAVE BEEN BERY PRUDENT IN DESCRIBING SCOPE OF G-10 DECISION. ANOTHER ITALIAN BANKER THOUGHT DECISION WAS USEFUL SIGN OF CONFIDENCE BUT WAS NO SUBSTITUTE FOR STABILIZATION PROGRAM.

9. COMMENT. ATMOSPHERE OF OPTIMISM ABOUT INDUXTRIAL ACTIVITY IN MILAN WAS IN STRONG CONTRAST WITH WORRIES IN ROME ABOUT FINANCIAL AND POLITICAL CRISIS. ONE ITALIAN BANKER SAID FRANKLY THAT BALANCE OF PAYMENTS PROBLEM WAS RESPONSIBILITY OF CENTRAL BANK AND NOT OF PRIVATE INDUSTRY. MOMENTUM OF INDUSTRIAL GROWTH AND CUSHION PROVIDED BY INVENTORIES OF IMPORTED GOODS MAY BE SUFFICIENT TO MAKE CY 1974 LOOK FAIRLY GOOD ON THE RECORD BOOKS. CREDIT IS NOT YET BITING BUT MAY VERY WELL BEGIN TO DO SO IN NEAR FUTURE. INTEREST RATES ARE INCREASINGLY DAILY AND ARE BEGINNING TO DISCOURAGE BUSINESSMEN WHO FORMERLY THOUGHT THAT THEY COULD PASS ADDITIONAL COSTS ON TO CONSUMERS. EFFECT OF PRIOR IMPORT DEPOSIT ON LIQUIDITY IS APPARENT AND MAY WELL HIDE SOME WEAKENING IN IMPORT DEMAND IN REAL TERMS. (IMPORT VALUE WAS DOWN 2 PERCENT IN JANUARY.) SOME BANKERS THOUGHT THAT SIGNS OF GOI WILLINGNESS TO ACCEPT TAX APCKAGE LIMITED OFFICIAL USE

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WAS GOOD SIGN BUT THEY ALSO EXPORESSED SOME SKEPTICISM ABOUT IMPLEMENTATION OF TAX MEASURES FOR FEAR OF TAX EVASION AND INEQUITY OF RAISING TAXES OF THOSE ALREADY PAYING. EXPORTS SEEM TO BE DOING QUITE WELL AND MAY DO BETTER, ESPECIALLY WITH HELP OF ANY FURTHER DEPRECIATION OF EXCHANGE RATE. ON OTHER HAND, FOREIGN CREDITORS ARE LOOKING AT ITALY WITH JAUNDICED EYE, WAITING TO SEE CONTENT AND EFFECT OF STABILIZATION PROGRAM VOLPE

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